Special Article

Safety Nets: An Issue in Global Agricultural Trade Liberalization

Global trade liberalization is expected to benefit many countries, including those developing countries that are net agricultural exporters and are able to respond to expanded market opportunities. Other low-income countries, however, have argued that their food security could be adversely affected by the reforms and have lobbied for some form of food-safety net or compensation. This issue was discussed in the Uruguay Round of international trade talks and is on the agenda of the current round.

During the previous round of trade negotiations, several studies on the potential impact of agricultural trade liberalization concluded that world food prices for a few key commodities would rise and possibly become more volatile as surpluses drop. If both results occur, low-income countries could experience greater food insecurity. Even without greater price volatility, an increase in food prices may escalate the problems of import financing for low-income countries that spend a significant share of their budgets on food imports and whose domestic production is highly variable.

Given these food security concerns, many developing countries have argued for improvement in safety net policies to minimize the impact of trade liberalization on their consumers. These concerns were discussed in several forums, namely the 1996 World Food Summit and the World Trade Organization (WTO) meetings. The result was a provision in the Marrakech Agreement that recognized concerns and initiated steps to improve international safety net mechanisms.

What are the Available Safety Net Programs?

Food importing countries have used safety nets provided by a range of programs in the past. Some of the programs continue while others have been revised or discontinued.

Food aid. Food aid has a long history and is the most important international food safety net program. The magnitude and role of food aid has changed through time, but its mission to address both chronic and transitory food insecurity has remained the same. Food aid was first provided to developing countries in the 1950s as the U.S. disposed of grain surpluses. For producers and exporters, food aid became a desirable policy choice because reductions in commodity surpluses usually boosted market prices. As commercial exports increased over time, the role of food aid diminished as a means of reducing commodity surpluses.

All food aid donors cite humanitarian relief as their basic distribution criteria, but economic and political considerations have also played important roles in allocation decisions. The commodity mix of food aid usually reflects the export profile of the donor country and tends to vary with yearly fluctuations in availability. Cereals (mainly wheat) are by far the largest category of

FAO photo

food aid. Currently, the major donors of grain food aid are the U.S., the European Union (EU), Canada, Japan, and Australia. The U.S. continues to provide food aid in commodity form, while the EU and Canada provide their food aid on a grant basis. Japan provides financial assistance for food aid programs such as the World Food Program.

The future of food aid is uncertain. One concern is the increasing cost of food aid as further global trade liberalization reduces or eliminates support prices and food surpluses in donor countries. The U.S. and EU—the two largest food aid donors—agree that food aid should be provided to the least developed net food importing countries. However, rising food prices in the future could reduce food aid volumes unless donor countries increase budgetary appropriations. Food aid volumes have not been sufficient to meet estimated needs in the past. With a growing gap between food needs and food availability in many low-income countries over the next decade, food aid will likely cover a smaller proportion of that gap.

EU's STABEX program. The EU conceived STABEX as a safety net program for low-income countries that were mostly former European colonies. However, the program has turned out to be more of a development program than a safety net program. Selected developing countries receive compensation when export earnings are below average (compared with recent trends). Compensation is provided as project grant aid, which is administered by local EU officials in cooperation with local country officials. Critics of the program point to inadequate funding, slow processing, and a rigid formulaic approach that ignores the impact on local reform processes. The EU recommended in 1996 that the program be modified or discontinued.

Special Article

International Monetary Fund's (IMF) Compensatory and Contingency Financing Facility (CCFF). The CCFF program provides compensation to countries either when global food prices have been unusually high or export earnings unusually low. One shortcoming has been that each country's compensation is limited to its share of available IMF funds. Another shortcoming has been that the IMF must first determine that a country's high food import costs or low export earnings are not the result of economic mismanagement. The time required for this determination has contributed to delays in processing country financial support requests. The program was little utilized in recent years (about two countries per year over 1993-99) and was terminated in 2001.

New Safety Nets Proposed

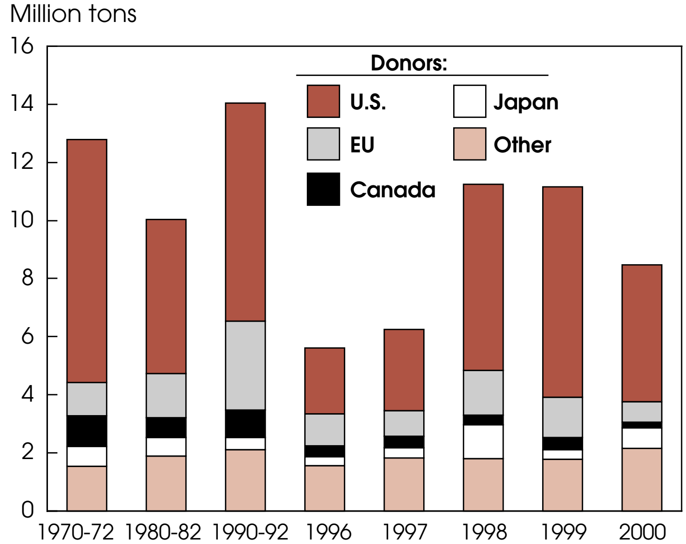
At the WTO meeting of trade ministers in November 2001, developed countries generally showed support for the broad goal of improving food security safeguards for low-income countries, but did not reach agreement on particular mechanisms to achieve this goal. Before the meeting, several new proposals were submitted to the WTO Committee on Agriculture. The EU proposed improving the effectiveness of food aid by making it available only to food-insecure low-income countries, and by requiring that it be provided only on a grant basis. Nigeria and South Korea proposed increasing the volume of food aid. Japan and Mauritius suggested creating an international grain reserve to reduce food price volatility. Several developing countries proposed that food-insecure countries be exempted from restrictions on domestic production subsidy programs. Egypt favored an international financial rebate system that would compensate food-insecure countries for costly food import bills. Other proposals called for reducing the financial burden on developing countries of transitory food import shocks.

Most of the proposals are "ideas" and are difficult to compare in terms of their operation and targeting. However, three proposed mechanisms have drawn recent attention.

International derivatives for grains. The goal of this proposal would be to stabilize food import prices by designing new derivatives (puts and calls) that give food-insecure countries the option to buy or sell food at either current market prices or at predetermined prices (purchased options). The options would help food insecure countries purchase food at more predictable prices. The program would protect countries against import price hikes, but not necessarily against import costs that result from their own domestic production shortfalls. Creative derivatives might need to be developed, such as an option to purchase grain 15 months in advance of the harvest (presently not available). A fund that subsidizes the options probably would be necessary. Developed countries could help in the design and funding of the program.

Revolving fund/financial rebate system. Under this proposal, food-insecure countries would be reimbursed from an international fund if food import costs for a selected basket of products exceeded a threshold. For example, if a country's total import costs were 10 percent above trend import costs, the country would receive compensation for the difference. The Food and

Food Aid (Cereals) Varies by Year, Largely Reflecting Production Surpluses of Donors



Based on data from the Food and Agriculture Organization of the United Nations. Data for 1970 through 1992 are annual averages.

Economic Research Service, USDA

Agriculture Organization of the United Nations estimated that such a program covering 65 food-insecure countries would have cost about $429 million per year over the 1989-99 period.

Import insurance program. Under this program, a variation of the financial rebate system, food insecure countries would pay annual premiums according to a predetermined historical risk profile. Depending on coverage options, countries would receive compensation whenever import costs exceed a threshold for a preselected consumption target. For one standard option, USDA recently estimated that program costs for 67 food-insecure countries would have been about $450 million over the 1988-97 period. The program would require a one-time startup cost of about $2-$3 billion to keep the fund solvent, after which the program would be self-financing with the collection of each country's premiums.

Comparing these proposals with food aid. Estimated costs of either the revolving fund or the import insurance program, $429-$450 million annually, can be compared with the latest food aid budgets. The combined food-aid budgets for the five major donors (Australia, Canada, EU, Japan, and the U.S.) totaled an estimated $2.9 billion in 1998. Hypothetically, it would be more cost-effective to channel these same food aid budgets into some of the proposed options, even if donor countries paid nearly all the costs.

All of the proposed programs would involve numerous administrative issues that would need to be addressed before deciding on the program or programs to implement.

Special Article

Defining Food-Insecure Countries

The Uruguay Round's Marrakech Agreement recognized the special needs of Least Developed Countries (LDCs) and the Net Food Importing Developing Countries (NFIDCs). In particular, the signatory countries agreed to review food aid periodically; ensure that an increasing proportion of foods is provided concessionally to LDCs and NFIDCs; and provide technical and financial assistance to these countries. Additionally, the signatory countries recognized that LDCs and NFIDCs may be eligible to "draw on the resources of existing international financial institutions under existing facilities, or such facilities as may be established."

The agreement raises two key questions: What are the criteria used to place countries in LDC and NFIDC categories? Are these categories synonymous with food insecurity? Answers to these questions are important for targeting food-insecure countries and determining the costs of various programs and proposals.

The United Nations determines which countries are considered LDCs (presently there are 48 countries). A variety of socioeconomic indicators are used in the determination, including per capita income, size of the manufacturing sector, literacy rates, a quality-of-life index, economic diversification, and population size. While the LDCs are undoubtedly poor and likely to be food insecure, they are not specifically identified as such.

The WTO's Committee on Agriculture makes the determination of which countries are considered NFIDCs (presently there are 18 countries). Specifically, countries that wish to be considered an NFIDC must petition the Committee and provide data to support the claim that they are net food importers of basic food items. While these 18 countries are particularly vulnerable to trade liberalization effects, there are undoubtedly many others that are food insecure and would be affected by trade liberalization.

Recently, the International Food Policy Research Institute (IFPRI) completed a study suggesting that countries should be more carefully classified and targeted in international treaties. Several criteria were used to classify the countries as food insecure, including per capita food production trends, the ratio of total exports to food imports, average calories consumed per capita per day, average proteins consumed per capita per day, and the share of the nonagricultural population. Using these criteria, IFPRI classified 74 food-insecure countries into four categories reflecting different degrees of insecurity.

While there is clear overlap in these country classifications, a careful identification of food-insecure countries would be helpful in targeting safety net programs and in minimizing program costs. Though not cited in international treaties, USDA also monitors annually the food security situation in 67 developing countries around the world. These 67 countries largely overlap the 74 countries identified in the IFPRI study. The countries monitored by USDA have been selected primarily because they have received U.S. food aid in the past.

New Food Safety Nets Will Support Trade Liberalization

While trade liberalization has the potential to improve the food security of developing countries, low-income countries that are not strong participants in global food and agricultural markets will remain vulnerable to price shocks and food insecurity. Presently, the international safety nets that do exist are inadequate to stabilize food supplies for the more vulnerable countries. Food aid has been the primary safety net, but is not sufficient to meet estimated needs around the world. With food gaps projected to grow wider in the future, the problem likely will only worsen. The few alternatives to food aid that have been implemented so far have been underutilized or highly ineffective.

New safety net proposals could help stabilize grain import prices or manage import costs. Recent estimates of selected proposals suggest that the costs could be much less than those of current programs. The costs of new proposals will vary depending on the type of safety net program and the countries targeted. In turn, the number of eligible countries will vary depending on the selection criteria. Improving international safety net programs may not only temper food security concerns, but also generate support among low-income countries for further trade liberalization. AO

Michael Trueblood (202) 694-5169
Shahla Shapouri (202) 694-5166
shapouri@ers.usda.gov
trueb@ers.usda.gov

For more information

Food Security Assessment, 2001
A forthcoming ERS publication
- The impact of widespread food production shortfalls in 2001 on low-income food-insecure countries
- Special report on China: Market reforms, policy initiatives and food security

Watch for it this month on the Economic Research Service web site www.ers.usda.gov

Issues in Food Security
Series of concise papers summarizing ERS research on global food security assessments; international food aid; natural resources and productivity; trade liberalization; and other topics
www.ers.usda.gov/publications/aib765/

Policy Options to Stabilize Food Supplies: A Case Study of Southern Africa
A range of safety net options and their costs
www.ers.usda.gov/publications/aib764/

Web briefing rooms

Developing countries in the World Trade Organization
www.ers.usda.gov/briefing/WTO/DevelopingCountries.htm

Global food security
www.ers.usda.gov/briefing/globalfoodsecurity/

Featuring on the ERS web site

USDA's Projections for 2002 and for 2002-11

USDA Agricultural Outlook Forum 2002

Held February 21-22

. . . Unveiled farm-sector projections for 2002 and the USDA Agricultural Baseline Projections to 2011

. . . Presented 2 days of information-packed sessions on agricultural prospects and related timely issues

At the annual Outlook Forum, a decades-old institution, crop and livestock prospects have long been a staple topic. Today's forum also explores the relationships between policy and markets, the challenges of delivering a safe food supply, and the economics of rural development. Among the offerings on this year's Forum program:

2002 Agricultural Prospects
Keith Collins, Chief Economist, USDA

U.S. Trade and Agricultural Policy
J.B. Penn, Under Secretary for Farm and Foreign Agricultural Services, USDA

Impacts of China's WTO Accession
Neilson Conklin, Director, Market and Trade Economics Division, Economic Research Service, USDA

Tracking Food Products for Quality, Safety, and Efficiency
Susan Offutt, Administrator, Economic Research Service, USDA

Coming Soon:

Outlook Forum speeches are available on the web on March 1. Meanwhile, browse through the 2001 Forum speeches, at http://www.usda.gov/agency/oce/waob/oc2000/pastyears.htm

Look for Outlook Forum-based articles on 2002 prospects and the impacts of China's WTO accession in upcoming issues of ERS's *Agricultural Outlook* magazine

USDA Agricultural Baseline Projections to 2011

Baseline highlights
http://www.ers.usda.gov/Briefing/baseline/summary.htm

Complete Baseline report
http://www.ers.usda.gov/publications/waob021/waob20021.pdf

Data tables
http://www.ers.usda.gov/db/baseline/

USDA Agricultural Baseline Projections to 2011

Released at the Forum, the 2002 Baseline indicates that slow U.S. and global economic growth and a strong U.S. dollar provide a weak setting for the agricultural sector in the initial years of USDA's long-term, 10-year projections.

Export competition and a strong dollar are projected to continue, but more vigorous global economic growth in the longer term, particularly in developing countries, leads to gains in trade and U.S. exports.

The projected results: rising market prices, increases in farm income, and improvement in the financial condition of the U.S. agricultural sector.